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APRIL 18, 1988

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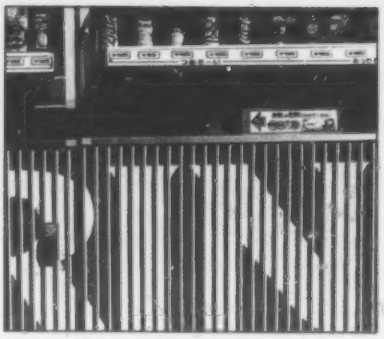

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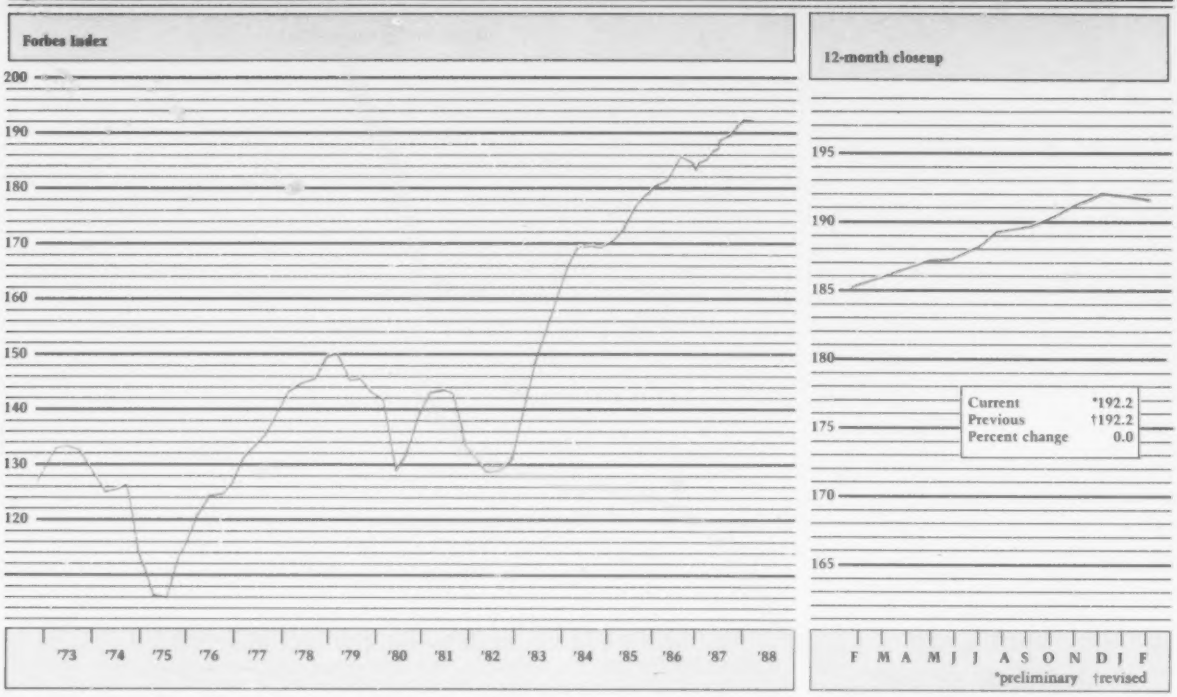
The Forbes Index



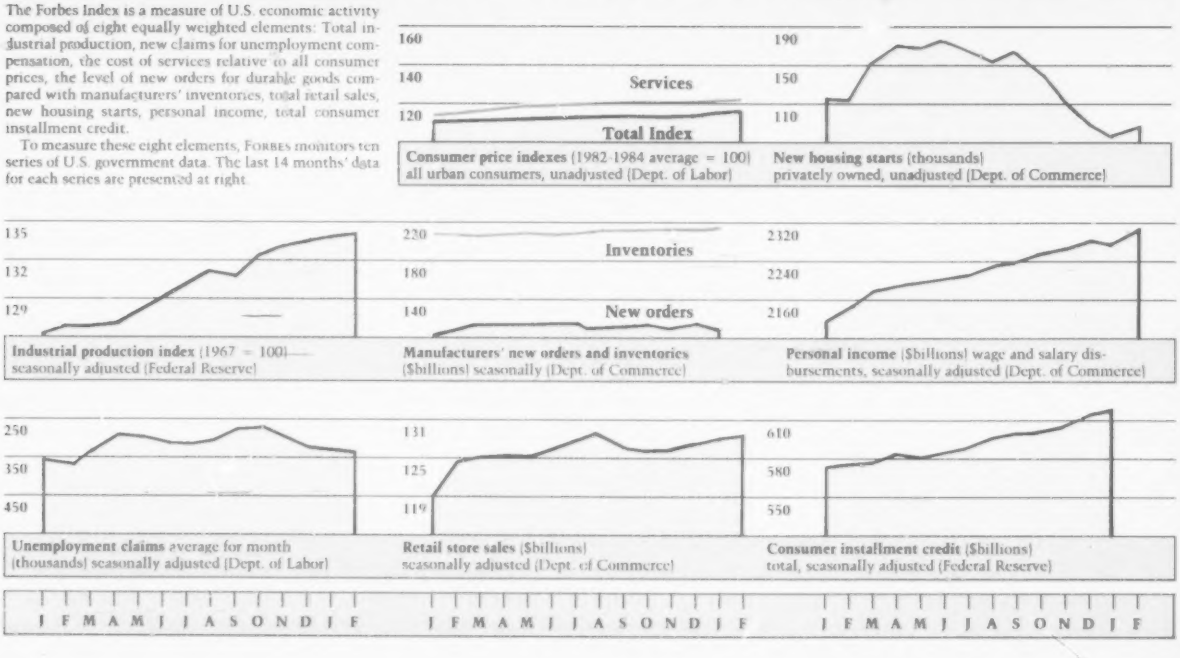
Going nowhere. Final results show the Forbes Index with less than a 0.1% gain in January. The preliminary February figure (manufacturers' new orders and inventory and consumer installment credit have not been reported yet) indicates a flat index even though several components posted gains.

The Consumer Price Index rose 0.3% in February before seasonal adjustment, the services component 0.4%. If Fed Chairman Greenspan keeps the money supply tight, inflation should stay low. New unemployment claims dropped a sharp 7% in February. This component has swung wildly in the last four periods, so the current trend is hard to determine. New housing starts were up 15.4%, while industrial production eked out a 0.1% gain.

The Forbes Index Components

The Forbes Index is a measure of U.S. economic activity composed of eight equally weighted elements: Total industrial production, new claims for unemployment compensation, the cost of services relative to all consumer prices, the level of new orders for durable goods compared with manufacturers' inventories, total retail sales, new housing starts, personal income, total consumer installment credit.

To measure these eight elements, FORBES monitors ten series of U.S. government data. The last 14 months' data for each series are presented at right.


160
140
120
Services
Total Index
190
150
110
Consumer price indexes (1982-1984 average = 100) all urban consumers, unadjusted (Dept. of Labor)
New housing starts (thousands) privately owned, unadjusted (Dept. of Commerce)
135
132
129
220
180
140
Inventories
New orders
2320
2240
2160
Industrial production index (1967 = 100) seasonally adjusted (Federal Reserve)
Manufacturers' new orders and inventories ($billions) seasonally (Dept. of Commerce)
Personal income ($billions) wage and salary disbursements, seasonally adjusted (Dept. of Commerce)
250
350
450
131
125
119
610
580
550
Unemployment claims average for month (thousands) seasonally adjusted (Dept. of Labor)
Retail store sales ($billions) seasonally adjusted (Dept. of Commerce)
Consumer installment credit ($billions) total, seasonally adjusted (Federal Reserve)
J F M A M J J A S O N D J F
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Practically everyone agrees that the cellular telephone business will change the way we work and play. But it may be late for investors to get in on this good thing.

Great expectations

By Howard Rudnitsky

ANALYST Dennis Leibowitz, of Donaldson, Lufkin & Jenrette, is nobody's fool, and when he calls the cellular telephone franchise business "one of the very few [businesses] with open-ended growth potential," you can't dismiss his optimism out of hand.

Especially so when some smart people are putting big money into the business of making it possible for Americans to talk by telephone in their cars. Last month BellSouth Enterprises President William O. McCoy offered $710 million in BellSouth stock for Mobile Communications Corp. of America, a cellular telephone and paging company based in Jackson, Miss. Mobile has franchises owned in partnership with BellSouth in Los Angeles and Houston. The offering price, which excludes some of Mobile Communications' paging assets, works out to 7½ times revenues, 30 times this year's projected cash flow and 100 times earnings.

For another rich little deal, consider American Cellular Network. Comcast Corp., a tightfisted cable TV operator based in Philadelphia, is paying $230 million—or 10 times revenues and 20 times projected 1988 operating cash flow—for AmCell.

Impressive personal net worths are abuilding. Mobile Communications' founder John Palmer, 52, and his associates will walk away with $70 million in BellSouth stock (plus some radio-paging assets) on a minuscule investment in cellular made five years ago. AmCell founders Sidney Azeez and John Scarpa will realize about $55 million on the roughly $7 million they put into the company five years ago. In Seattle, McCaw Cellular's 39-year-old Craig McCaw has created a $1 billion fortune for his family and a second fortune for the Taylor and Jordan families, who control Boston's Affiliated Publications *(see box, p. 59)*. And there are more such tales.

So big are the numbers getting, it's only fair to ask: Has cellular gotten ahead of itself? Are prices reaching

Rob Nelson/Picture Group

William McCoy, BellSouth Enterprises president
Betting $710 million more on a cellular future.

Cellular plays

In each market, cellular telephone franchises have been awarded to the local telephone company and an independent. But the telephone companies have begun buying up independent franchises in other markets, which probably makes sense given their financial might and staying power in the face of a recession.

Company/major markets	Market value ($mil)	Shares outstanding[1] (mil)	Total net population[2] (mil)	Net population per share	Subscribers (000)	Long-term debt ($mil)	Cash flow[3] ($mil)	Price recent	Price 52-week high low
Telephone companies									
PacTel/CA, MI, GA	$12,423	432	28	0.07	155	5,321	2,657	28¾	33⅜–22½
BellSouth/GA, FL, TX	18,769	481	27[4]	0.06	74	6,320	4,163	39	43½–29⅛
SWBell/IL, DC, TX	11,030	300	27	0.09	150	5,649	2,697	36¾	45½–28¼
Nynex/NY, MA, RI	13,458	204	22	0.11	75	6,076	3,307	66	78⅛–58
GTE/TX, CA, FL	12,456	330	21	0.06	66	9,587	3,556	37¾	44⅜–29⅛
Ameritech/IL, MI, OH	12,515	139	20	0.14	90	4,389	2,981	90¼	99⅞–74
Bell Atl/PA, DC, MD	13,748	198	19	0.10	64	5,199	3,357	69⅜	79¾–60½
US West/AZ, CA, MN	10,093	190	14	0.07	50	4,949	2,647	53⅛	60½–42½
Centel/NV, VA, NC	2,153	44	6	0.14	15	883	358	49½	50¼–32¾
Independents									
McCaw/FL, TX, CA[5]	2,494	112	47	0.42	132	1,038	–64	22¼	26 –11
Lin Broadcasting/NY, PA, TX	2,792	52	18	0.35	150	48	106	53⅜	57⅞–21½
Metro Mobile/CT, AZ	849	26	10	0.38	22	76	–9	32¾	33½–12¾
Cellular Comm/OH, TX	471	20	7	0.35	25	134	–3	23	23¾– 7
Mobile Comm Amer/TX, CA[6]	621	24	6	0.25	40	124	24[7]	26⅛	33½–12¾
Vanguard/PA, FL	210	10	5	0.50	9	30	–8	21	22 –20

[1]As of Dec. 31, 1987. [2]Population within franchise area. [3]For independents, cash flow is operating income plus depreciation and amortization. For telephone companies, cash flow is net income plus depreciation and amortization. [4]Includes 50-50 joint partnership with Mobile Communications. [5]43% owned by Affiliate. [6]Acquisition by BellSouth pending. [7]Cellular losses are absorbed by BellSouth.

Sources: RCR Publications; company reports and Forbes estimates.

tulip bulb proportions?

There is no question that cellular is an important breakthrough in telecommunications. A local cellular franchisee divides an area into cells 5 miles to 10 miles in radius. The franchisee installs low-power transmitters and receivers in each cell; these in turn are connected by microwave transmitters or land lines to mobile switching stations. As a car leaves one cell, the switching station automatically transfers the call to the next cell, and so on. The switching station also connects the mobile telephone to the local, long distance and international telephone phone lines.

With today's newer portable phones, you can walk down Fifth Avenue in Manhattan while talking to your spouse in Boise, or your partner in Tokyo. Pretty soon the gear will be cheap enough that teenagers can take a phone with them on dates. No more, "Gee, Mom, I would've called but I didn't have a quarter." In the U.S. the car facsimile machine is just around the corner. So cellular communications is no gadgety gimmick: It is a service that fills a real need for a society on the go.

But in the real world of business, there's many a slip twixt cup and lip. With little in the way of earnings or cash flow, cellular franchises today sell on the basis of two expectations: (1) the number of potential customers in the area covered by their franchise, and (2) how much each of those customers is likely to spend. The first expectation is the population that lives in the cellular franchisee's area—the so-called pops figure. If a franchise area has a population of, say, 2 million, and a company owns 60% of the franchise (partners accounting for the rest), then the company would have 1.2 million pops.

What's a pop worth? BellSouth is paying some $80 to $85 a pop for Mobile Communications. McCaw, which about 18 months ago was paying only about $20 per pop for franchises, a few months ago paid $80 a pop for the Washington Post Co.'s Florida cellular business. McCaw itself is being valued in the stock market at $75 to $80 a pop.

These prices are assuming a great deal. They assume that a significant percentage of the pops will sign up for the services and that, once signed, they will use the expensive service on a big scale.

When the Federal Communications Commission started to divvy up the cellular industry in the early 1980s it awarded two franchises for each market, to make sure there was competition. The "wireline" franchise went to the local Bell operating company. The independent or "nonwireline" franchise was at first chosen by the FCC in some markets. Later markets were awarded by lottery.

Let's crunch a few numbers. What "per pop" amounts to is an assumption that a given independent company will have about half the cellular market, and the local phone company will have the other half. Let's say cellular's penetration will be 4% five years from now. Then the independent franchisee's penetration will likely be 2%.

Let's go on with the numbers. If the franchise covers 1 million pops and ultimately signs 2% of them, it will have 20,000 customers. Paying $80 a pop is the same as paying $4,000 today for tomorrow's projected customer. By contrast, cable TV systems can currently be purchased for around

$2,000 per existing subscriber.

Is $4,000 per potential subscriber too much? That depends on how much the subscriber, if he materializes, spends. Donaldson, Lufkin & Jenrette's Dennis Leibowitz, like most cellular analysts, believes cellular operators' gross margins will be around 50%. Five years from now, he projects, "the average cellular subscriber will generate $460 per year in cash flow, and be worth $6,000 each." Leibowitz goes on to predict that in 1993, "cellular could well achieve 5% penetration levels, which would translate into 9 million customers, or nine times 1987's 1 million cellular customers."

Optimists like Leibowitz argue that costs will drop and the convenience will rise, making cellular phone service more irresistible than it is today. New portable cellular phone models can be carried around in a briefcase or large pocketbook. Prices, typically $4,000 a year and a half ago, are expected to drop from today's $1,495 to below $500 in 1993. More automakers—especially the Japanese—will follow BMW's lead and make cellular phones standard equipment on top-of-the-line models.

Fredrick Moran is president of Greenwich, Conn. money manager Moran Asset Management. He has made a lot of money for his clients in American Cellular (he controlled 9%) and other cellular plays. Moran says: "With 5% penetration, cash flow per subscriber will be over $550 and each one will be worth $9,000."

Impressive numbers, but remember this: All this is simply playing with numbers. Nobody really knows what percentage of a given pop will sign up nor how much each will use the service. To create the cash flow of $450 to $550 per customer that the analysts predict would require that the average customer run up annual bills of $900 to $1,100. When added to the home phone bill, that's a lot of money for the average person.

In the real world, new customers are costly to attract. Last year McCaw Cellular, with franchises covering 47 million pops, spent $61 million on marketing, but added only 100,000 customers. That's a lot to pay per customer, any of whom can cancel at any moment. Indeed, the industry's "churn," as cancelations are known, sometimes reaches as high as 3% per month. Even at the more typical 1% per month cancelation rate, a cellular operator must add 12% more subscribers annually just to stay even.

In this growth industry, as in any growth industry in its early stages, things that can go wrong often do.

Older investors may remember that, beginning in the late 1960s, lots of smart folks thought cable TV would become a huge industry. Much capital was raised to buy franchises, string cable and sign up customers. True to expectations, cable today is indeed a big and profitable business. But a number of cable operators nearly went under in the 1973-74 recession. Investors who missed the first cable stock runup had a second chance to buy in cheap.

There's upside leverage in adding customers to a fixed-cost system. But leverage works both ways. The typical user now spends over $100 a month for the service. But as marginal customers are added, the average bill could drop. It could drop, too, in a recession. If usage dropped to $75 a month from $100, profit margins woud fall even faster because of the industry's relatively high fixed costs.

Cellular is growing so rapidly, and from such a small base, that extrapolations are hazardous. Up to now, cellular has been so expensive that it has attracted primarily business users not overly concerned about price. Price competition is mainly in the form of the basic charge. But the fact that price wars between the wireline and nonwireline franchisees have not yet broken out does not mean they won't break out. Cellular phone rates are not regulated by the FCC. Come a recession (and there will come a recession), cellular operators with sizable fixed costs to support could be in trouble. In such an environment, the deep-pocketed Bell operating company franchisees would seem the likely victors.

Considering all this, more than one old hand has considered the future, and decided to hedge it with a little cash. Well-managed Lin Broadcasting, which has $214 million in cash and very little debt, has 18 million pops in key markets like New York, Los Angeles, Philadelphia and Houston and wants more. But not at current prices.

Philip Gould/Matrix

John Palmer, Mobile Communications of America chairman
BellSouth's offer was too good to refuse.

Eastern money, western brass

Rich Frishman

McCaw Cellular's Craig McCaw
A bountiful partnership.

Fifteen years ago McCaw Communications consisted of some radio station assets and a tiny cable TV operation. Today McCaw, of Kirkland, Wash., near Seattle, is the biggest cellular telephone company in the country. It has 127 franchises covering a total population of 47 million. It also has $1 billion in debt. Market capitalization: $2.5 billion.

The company is the product of Craig McCaw, now 39, who, after his father's death in 1969 was forced to run the business while still an undergraduate at Stanford. By 1981 McCaw needed money to expand in cable. Enter Boston's Affiliated Publications, publisher of the *Boston Globe* and controlled (51%) by Boston's Taylor and Jordan families. Bill Daniels, a leading cable broker, brought them together, and they entered into what turned out to be one of the decade's more bountiful partnerships.

Starting with an initial $12 million from Affiliated (its total investment has come to $82 million) McCaw was able to expand rapidly. He borrowed liberally to buy cable systems just before their cash flows and prices rose.

By 1984, the new cellular telephone franchises were up for grabs. But that required McCaw's full-time attention and lots more money. In the spring of 1987 McCaw sold its cable TV business to Jack Kent Cooke for $755 million. McCaw received $165 million or so after taxes and debt repayments. Now Craig McCaw is betting the roll on cellular.

Affiliated's management swallowed hard but agreed to bet again on young McCaw. To raise more money to buy franchises McCaw established a public market for its shares. It sold a 13% stake to the public in a newly created company called McCaw Cellular Communications for $309 million ($21.75 a share) last August, and sold $600 million of debt. At year-end McCaw's net working capital was down to $387 million. Operating cash flow last year ran at minus $64 million. McCaw Cellular President Wayne Perry says losses will continue at least through 1988.

When will McCaw Cellular's cash flow turn positive? An Affiliated Publications executive suggests that it may happen in 18 months or so—if, he says, Craig McCaw doesn't make additional acquisitions.

McCaw is a master at negotiating for franchises but has yet to show that he can operate a huge system efficiently. Meanwhile, system construction and marketing costs continue to be onerous. To help ease the debt-service burden (around $10 million a month), McCaw and Affiliated recently agreed to put $165 million of cash and their profitable radio-paging business into the company in return for shares of McCaw Cellular stock.

Whatever lies ahead, the principals right now have few complaints. Craig McCaw holds voting control through a trust agreement with his family and Affiliated. After pending transactions are consummated, the McCaw family will own some 64 million shares with a market value (at current prices) of $1.4 billion. Affiliated Publications owns 61 million shares worth $1.3 billion—more than the mature *Boston Globe*. That's not a bad return on $82 million.—**H.R.**

Lin offered to buy American Cellular, but wouldn't go near Comcast's successful $230 million offer.

Within the last year or so, the Washington Post Co. has sold all its cellular operations. The Post sold its Florida cellular business to McCaw Cellular in January for $240 million, almost twice its cost. Shrewd media entrepreneur John Kluge sold his Metromedia cellular and paging holdings late last summer to Southwestern Bell for $1.35 billion.

Are these smart folks saying cellular is about to collapse? Not necessarily. They're simply saying that current prices are high, and that there are other, more profitable things to do with their money.

Okay. You understand the risks. You appreciate that some knowledgeable players have already left the table. You still think cellular is the wave of the future, and you want a piece of the action.

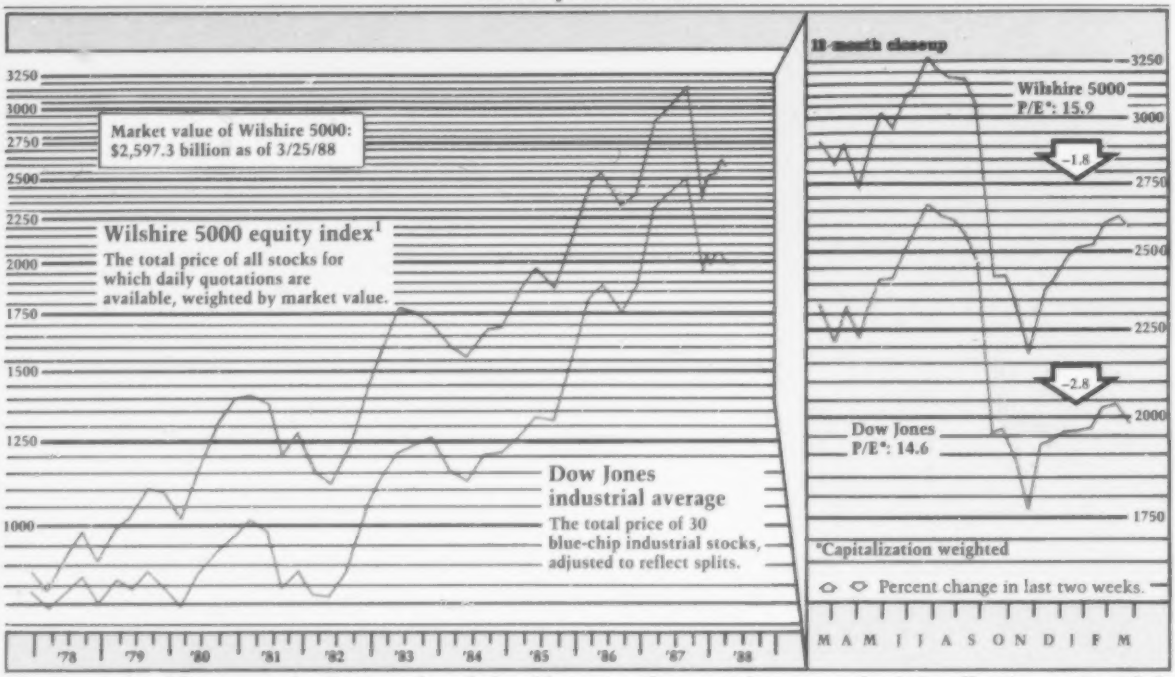
Unfortunately, only a few publicly traded independent cellular companies remain *(see table, p. 57)*. Their market prices already reflect most of the good things—and few of the bad things—that could befall the industry.

As Wall Street will, Drexel Burnham and Merrill Lynch moved to fill demand last month when they brought a small startup company, Vanguard Cellular System, public. Operating mainly what it calls a "Pennsylvania supersystem," Vanguard has a market value of $210 million, or 4 times its current equity. The stock is a rank speculation at these prices but sold well because the demand for such stocks currently exceeds the supply. But this situation is unlikely to continue. Some telephone operating companies can be expected to spin off part of their cellular operations, in order to take advantage of today's high cellular stock prices. Contel and USWest, in particular, may well go this route.

Cellular probably will be a big business in the years ahead. But it will not travel from here to there along an ascending straight line. Better safe than sorry. ■

The Forbes/Wilshire 5000 Review

Edited by Steve Kichen



The Dow's brief fling over the 2000 mark ended as blue chips and primary stocks suffered losses. But secondary issues finished the four-week stretch with impressive gains, even though the overall market fell sharply in the final two trading days. The yardsticks below indicate that investors shied away from large companies in favor of more speculative investments. In the last four weeks shares of companies with market capitalization of over $1 billion rose only 0.1%, while the stocks of small firms (market capitalization under $17 million) rose 9%. While high-growth issues increased 7.4%, low-growth stocks rose only 2.2%. And stocks priced under 4 appreciated 9.8%, while shares priced over 40 were up only 1.9%.

At the final bell the Dow was off 2.2% and the NYSE, 0.8% for the four-week period. In sharp contrast, Amex shares were up 3.6% and Nasdaq stocks, 2.5%. Large-cap stocks dragged down the overall market, as the Wilshire index fell 0.3%.

Closeup On the Equity Markets

Performance of six leading indexes

Percent change	Wilshire 5000	Forbes 500[2]	Dow Jones industrials	NYSE Composite	Amex Market Value Index	NASDAQ Composite
in last 4 weeks	–0.3	–1.7	–2.2	–0.8	3.6	2.5
in last 52 weeks	–13.2	–13.4	–15.3	–12.9	–12.9	–14.7

Stock performance based on six key investor yardsticks

Percent change	Company size		Volatility[3]		P/E multiple		Dividend yield		Growth profile[4]		Share price	
	large	small	high	low	over 25	under 5	over 7.5%	none	high	low	over $40	under $4
in last 4 weeks	0.1	9.0	9.1	2.1	6.1	3.0	0.7	7.8	7.4	2.2	1.9	9.8
in last 52 weeks	–8.2	11.3	11.3	1.4	–8.8	–9.4	–6.4	16.2	12.4	–2.1	–4.8	11.8

[1]Wilshire index reflects price performance. It differs slightly from market value of outstanding stocks because of retirements of equity since index was created. [2]Based on sales. [3]A stock's sensitivity to overall market movement. High-volatility issues have wide price fluctuations, low-volatility issues are more stable. [4]A quantitative evaluation of a stock's growth image, determined by Wilshire Associates.

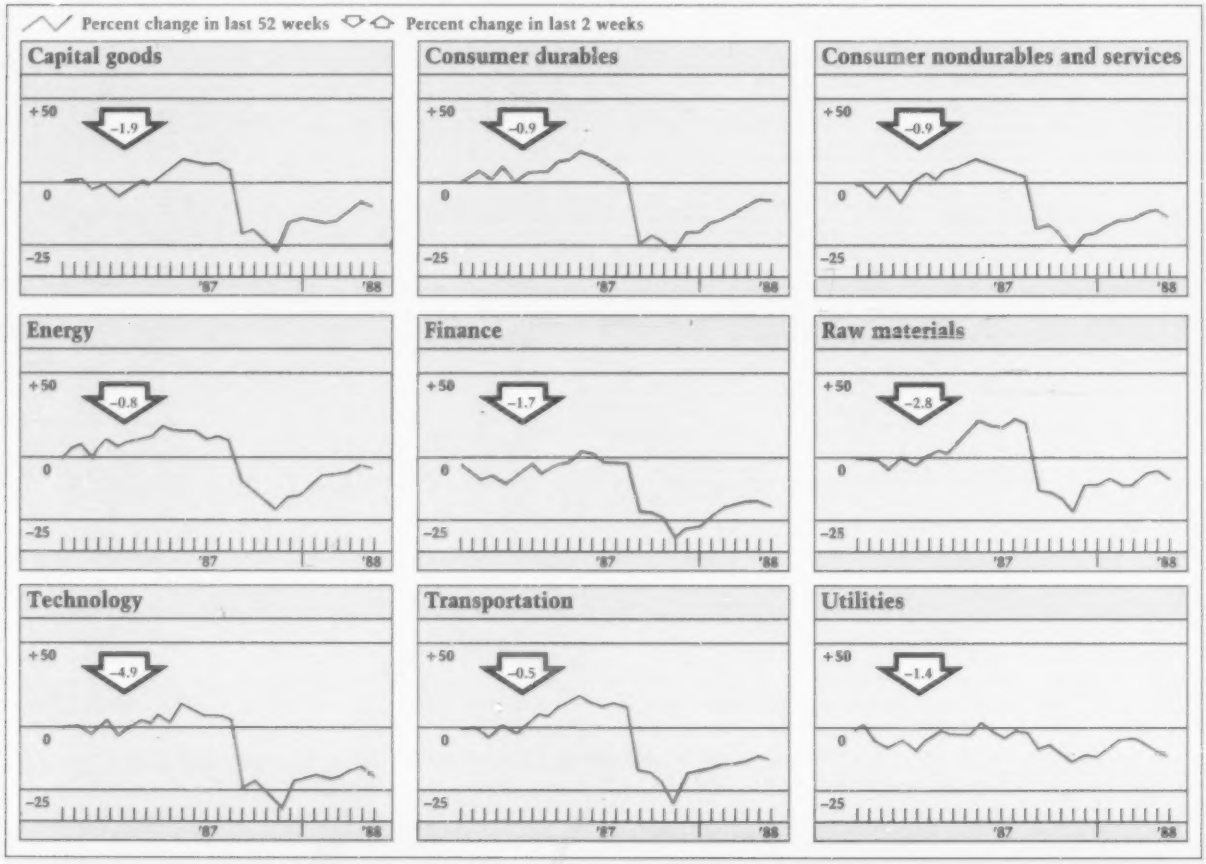
Note: All data for periods ending 3/25/88. Prepared by Wilshire Associates, Santa Monica, Calif.

Gay French

Where the Action Is

Reverse technology. The sharpest losses of the last two weeks were suffered by the technology group, which fell 4.9%. Lotus Development, which announced a delay in a new release of its flagship software product, 1-2-3, fell almost 22%. While Varian Associates, Tandem Computers, Digital Equipment and Computer Associates International also posted double-digit declines, Grumman bucked the trend and rose 17% on takeover speculation.

Raw materials and capital goods also dropped more than the overall market, while transportation stocks showed the smallest decline, a loss of 0.5%. Texas Air shot up almost 18%, as several major carriers raised their airfares.



What the Analysts Think

Analysts are nervous about 1989. The Forbes Sales 500 are priced at 10.6 times estimated earnings for fiscal 1988 and 9.6 times 1989 estimates. Put another way, analysts expect about a 10% earnings increase from the current fiscal year (1988) to the next. One year ago they were predicting an 18% to 20% jump in next fiscal year profits.

Forecasting the Forbes Sales 500

Performance period	Average earnings per share	P/E
latest 12 months	$2.56	14.7
1988 estimates	3.52	10.6
1989 estimates	3.94	9.6

Rank based on change in estimate	Sector	Estimated 1988 EPS	Estimated 1988 P/E	% change in 1988 estimate in 2 weeks	% change in 1988 estimate in 4 weeks
1	Raw materials	$2.92	11.3	0.94%	1.58%
2	Consumer durables	3.88	13.3	0.83	1.01
3	Capital goods	2.51	14.7	0.15	–0.18
4	Consumer nondurables	2.55	12.9	0.09	–0.17
5	Technology	2.82	11.4	–0.09	–0.32
6	Energy	2.95	13.1	–0.33	–0.37
7	Transportation	2.44	12.3	–0.54	–0.58
8	Utilities	2.44	9.5	–0.54	–0.81
9	Finance	3.47	7.6	–1.09	–1.82

Earnings projections are capitalization-weighted consensus estimates from over 2,000 security analysts. Data are compiled and updated continually by the Institutional Brokers Estimate System (IBES), a service of Lynch, Jones & Ryan, a New York-based brokerage firm.

Note: All data for periods ending 3/25/88. Prepared by Wilshire Associates, Santa Monica, Calif.; IBES, a service of Lynch, Jones & Ryan, New York.